No. 12588

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARGARET BRYAN SMITH,

Appellant,

vs.

HARRY C. WESTOVER, United States Collector of Internal Revenue, Sixth Collection District of California,

Appellee.

Appeal from the United States District Court for the for the Southern District of California,

---

BRIEF FOR THE APPELLEE.

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BRIEF FOR THE APPELLEE.

Opinion Below.

The District Court made findings of fact and conclusions of law. [R. 102-104.] Its memorandum opinion [R. 95-101] is reported at 89 Fed. Supp. 432.

Jurisdiction.

This appeal involves federal income taxes for the calendar year 1944 in the amount of $14,510.27, plus interest. The taxes in controversy were paid to the Collector on various dates between April 12, 1944, and January 13, 1945. [R. 9, 61.] Taxpayer filed a claim for refund on May 6, 1946, which was denied by the Commissioner of Internal Revenue and notice of such denial was transmitted to the taxpayer on December 23, 1947. [R. 65.]

Within the time provided in Section 3772 of the Internal Revenue Code and on March 18, 1948, the taxpayer brought an action in the District Court of the United States for the Southern District of California, Central Division, for the recovery of a portion of the federal income tax paid by the taxpayer for the taxable year 1944. [R. 66.] Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1340. Judgment was entered for the Collector on April 18, 1950. [R. 105-106.] Within sixty days and on May 15, 1950, a notice of appeal was filed. [R. 107.] The jurisdiction of this Court is invoked under 28 U. S. C., Section 1291.

Questions Presented.

1. Taxpayer, who was the life beneficiary of a testamentary trust created by her father, was entitled to receive each year an amount equal to five percent of the fair market value of the corpus of the trust. Income of the trust was to be added to corpus for the life-time of the taxpayer. During the taxable year, the net income of the trust was $24,348.14, and $18,356.36, which was equivalent to five percent of the fair market value of the corpus of the trust, was paid to the taxpayer. Was the District Court correct in holding that the amount distributed to the taxpayer was income to the taxpayer under Section 162(b) and (d) of the Internal Revenue Code?

2. If the first question is answered in the affirmative, are those provisions in conflict with the Sixteenth Amendment of the Constitution?

Statutes and Other Authorities Involved.

These will be found in the Appendix, *infra*.

Statement.

The District Court found the facts as stipulated. [R. 102.] They may be summarized as follows:

Taxpayer's father, John B. Bryan, died testate on September 18, 1938. [R. 63.] His will, after provision for payment of debts, set up a residuary trust with taxpayer and the Security-First National Bank of Los Angeles [R. 51] as co-trustees. [R. 31-50.] The will defined "net income" as the gross income received from trust property less trust expenses and provided that such net income during taxpayer's life should be added to the trust corpus and thereafter be considered as principal of the trust. It was further provided that the co-trustees were to annually pay the taxpayer five percent of the fair market value of the corpus of the trust, in monthly payments if possible, based upon an annual appraisal of the trust corpus by a banking institution. [R. 41-42.]

In the taxable year 1944, the gross income of the trust was $26,663.91. The net income of the trust after deductions was $24,348.14. Payments totaling $18,356.36 were made by the trustees to the taxpayer as beneficiary of the trust. In reporting the trust's income, the fiduciaries deducted $18,356.36 as an income distribution paid to the beneficiary. Consistently, the taxpayer, in computing her individual income tax for the year 1944, included the $18,356.36 as her income. [R. 64-65.]

Thereafter the taxpayer filed a claim for refund on the theory that the amount paid to her by the trust in 1944 was a bequest of principal and not a distribution of income. The claim was denied and an action was brought

in the District Court for the Southern District of California. [R. 65-66.] The District Court rendered judgment for the Collector, concluding that the $18,356.36 paid to the taxpayer in 1944 by the trust fiduciaries was a distribution of income fully taxable to the taxpayer as the recipient. [R. 103.]

Summary of Argument.

1. Section 162(b) and (d)(1) of the Code, as amended in 1942, provides that distributions to beneficiaries of estates and trusts are taxable to the beneficiaries if they "can be paid * * * out of other than income" providing that the amounts distributed do not exceed the income of the estate or trust for that year. Since the trust had net income in excess of $24,000 and only $18,356.36 was distributed to the taxpayer, the direction of the testator that taxpayer was to be paid out of principal is ineffective to immunize her from tax on the unambiguous statutory provision. The contention that Section 162(d)(1) was inserted in the Code to deal only with the situation illustrated by *Burnet v. Whitehouse, infra,* where the annuity was to be paid out of income but corpus could be invaded if necessary, is refuted not only by the statute itself, but by decisions of this and other courts, by the legislative history and by the Regulations.

2. The contention that Section 162(d)(1) as interpreted below is unconstitutional is equally untenable.

First, the question is not even open here on the familiar principle that questions not raised below, particularly con-

stitutional questions, may not be availed of to overturn the decision of a trial court.

Second, if open the contention fails because it is based on untenable assumptions. One such assumption is that taxpayer received a gift of principal. This overlooks the substance of the situation which, on the authority of a long and undeviating line of Supreme Court decisions, is controlling when the constitutionality of income tax provisions is questioned. The taxpayer, as beneficiary, received in excess of $18,000 which the testator labeled "corpus," but since the corpus, theoretically reduced by the distribution, was restored simultaneonsly by the transfer of "income" to it, it is plain that the trust's increment was paid to taxpayer. The contention that Congress is powerless to disregard the nomenclature and tax the trust income to its recipient is, then, not only in conflict with all the authorities, but is transparently without merit.

A second assumption, which need not be reached if we are correct in our analysis of the substance of the situation, is that a gift of principal is not constitutionally taxable to the recipient. The question in its full application has never been decided because Congress has generally exempted gifts from income tax, but no good reason has here been advanced and we think that there is none to prevent their taxation. Moreover, in situations analogous to this one, the tax has been upheld as against the attack that the taxpayer-donee was being taxed on a gift of principal.

ARGUMENT.

I.

The Distributions Received by the Taxpayer as Beneficiary of the Trust During the Taxable Year Were Income Taxable to Her Within the Meaning of Section 162(b) and (d)(1) of the Internal Revenue Code.

1. It was the original purpose of Sections 161 and 162 of the Internal Revenue Code, and their counterparts in the various Revenue Acts in effect prior to the adoption of the Code, to tax all income of estates or trusts either to the trust or to the beneficiary. (*Helvering v. Butterworth,* 290 U. S. 365; *cf. Freuler v. Helvering,* 291 U. S. 35.) Prior to the amendment to Sections 22(b)(3) and 162 made by Section 111 of the Revenue Act of 1942, c. 619, 56 Stat. 798, many difficult questions had arisen as to whether the beneficiary or the fiduciary was taxable on the income earned by the estate or trust. Because Section 22(b)(3) of the Code, prior to its amendment in 1942, specifically exempted the value of the property acquired by gift, devise, bequest or inheritance (except the income from such property), it was held that distributions out of income made by trustees to beneficiaries which, under the terms of the trust instrument, were to be made regardless of the sufficiency of the trust income, were not deductible by the trustees under Section 162, and hence the income was taxable to the trust and not to the beneficiaries. (*Burnet v. Whitehouse,* 283 U. S. 148; *Helvering v. Pardee,* 290 U. S. 365.)

In order to eliminate the problem of whether the distribution to the beneficiary was taxable to him when the trust actually had income equal to or in excess of the distribution of which the *Whitehouse* and *Pardee* cases were

illustrative of only one phase, Section 111 of the Revenue Act of 1942 was enacted to amend Section 22(b)(3) and Section 162 so that income of a trust or estate is taxed to the recipient beneficiary regardless of the nomenclature used to designate the source of payments to the beneficiary.[1]

This case falls squarely within the precise language of Section 162(d)(1) of the Internal Revenue Code, Appendix, *infra,* which was added to the Code by the 1942 amendment, and it is a classical example of the problem with which the 1942 amendment was intended to cope. In 1944 the trust received net income of $24,348.14 and the taxpayer received distributions from the trust of $18,356.36. [R. 64.] Under the trust instrument, no other beneficiary was entitled to a distribution of income, and in fact none was distributed to any other beneficiary. The contention (Br. 22-23) that the $18,356.36 was not income to the taxpayer because it was required by the terms of the trust to be paid out of principal is directly contrary to the purpose of the 1942 amendment as explained above, and to the plain language of that amendment. Thus, in the language of Section 162(d)(1), the payment of $18,356.36 to the taxpayer in 1944 by the trustees is a case—

> where the amount paid * * * out of other than income * * * during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid * * * if the aggregate of such amounts so paid * * * does not exceed the distributable income of the estate or trust for its taxable year.

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[1]Excluding, however, lump sum gifts which are not here involved.

Since it is undisputed that the distributable income of the trust was \$24,348.14 for the year 1944, the \$18,356.36 paid out of other than income, *i. e.*, principal, is the exact situation which Section 162(d)(1) describes.[2]

A problem similar to that involved here was before this Court in *Laughlin's Estate v. Commissioner,* 167 F. 2d 828. This Court there permitted a deduction to an estate of periodic payments made to the decedent's divorced wife pursuant to a property settlement incident to divorce. This Court pointed out (p. 830) that "Counsel for the Government conceded on oral argument that it is immaterial that the agreement between Homer [the decedent] and Ada Laughlin failed to require the \$9,600 to be paid out of income. Where the amount paid, credited or to be distributed can be paid, credited or distributed out of either income or corpus, it shall be considered as income of the estate or trust" provided the trust income is equal to or in excess of the distribution. That case was not a situation such as *Whitehouse* where payments were directed to be paid out of income and corpus was to be invaded only if income were inadequate but was a case where the payment was required to be made without designation of the source of the payment. It was, therefore, possible for the trustees to make the payment so far as the terms of the agreement were concerned completely out of corpus. Nevertheless, this Court correctly held (as

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[2]This provision directs the result below because (1) Section 162(d), Appendix, *infra,* is entitled "Rules for Application of Subsections (b) and (c)", (2) Section 162(b), Appendix, *infra,* provides that the trust shall have a deduction for income "to be distributed currently * * * but the amount so allowed as a deduction shall be included in computing the net income of the * * * beneficiaries * * *," and (3) thus, Sections 162(b) and (d) read together expressly require that these distributions be taxed to the taxpayer as her income.

we there conceded, against our interest) that the estate could take the deduction which, of course, under Section 162(b) would require that the wife include the payment in her income. See also *Carlisle v. Commissioner,* 165 F. 2d 645 (C. A. 6th), where the court interpreted Section 162(b) of the Code, as amended by Section 111(b) of the Revenue Act of 1942, *supra,* to require that a capital gain be taxed to the beneficiary, notwithstanding that it was part of the corpus of the estate received as an inheritance under state law. These cases clearly establish that the source of the payment under the amendment to Section 162(b) is immaterial on the question whether the distribution is income in the hands of the beneficiary and fully support us here. They additionally show that the 1942 amendments to Section 162 were not limited to the *Whitehouse* situation as taxpayer contends. (Br. 19.)

Not only does the language of Section 162(d) literally cover the instant case and the decisions under it support our position, but there is no doubt that it directs a result fully contemplated both by the drafters of the statute and by those charged with its administration. S. Rep. No. 1631 on H. R. 7378, which became the Revenue Act of 1942, stated as follows with respect to Section 162(d) (1) (S. Rep. No. 1631, 77th Cong., 2d Sess., p. 72 (1942-2 Cum. Bull. 504, 560)):

> Section 162(d)(1) applies to all cases in which the executor or trustee can or *must* (by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest, devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir, or beneficiary of a lump sum gift, bequest, devise, or inheritance. (Italics supplied.)

In the face of this language, taxpayer's contention that Section 162(d) was *intended* to deal only with the problem of *Burnet v. Whitehouse, supra,* and similar cases, is additionally untenable. The Senate Finance Committee Report in stating that Section 162(d)(1) applies to distributions which were required to be paid "out of other than income," *i. e.,* principal, when read with Section 162 (b) expressly covers this situation. The phrase "must * * * pay a whole or any part of a * * * devise out of other than income"[3] is unequivocal.

Similarly, it is clear that the Treasury Department has always considered that Section 162(d)(1) applies to a distribution such as that involved here even though directed by the terms of the trust instrument to be paid out of principal. Thus, Section 29.162-2, Treasury Regulations 111, Appendix, *infra,* provides that "Section 162 (d)(1) applies to all cases in which the executor or trustee can or must (for example, by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest, devise, or inheritance out of other than income * * *." Since the Regulation is in precise accord with the Committee Report and in any event does no more than give effect to the literal language of Section 162(d)(1),

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[3]The conclusion directed by the statutory language and the Finance Committee Report that the intended scope of Section 162(d) was not only that of the problem of the *Whitehouse* case is also confirmed by the fact that the House Bill (H. R. 7378, Section 110) which, according to the Report of the Ways and Means Committee (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 1 (1942-2 Cum. Bull. 372, 407-408)), was limited as taxpayer suggests (Br. 18-19) was completely revised in the Senate draft (H. R. 7378, Section 111) where the provision in Section 162(d)(1) upon which we rely was added and which as explained in that portion of the Senate Report quoted above, was intended to cover the exact situation involved here.

there can be no doubt that the Regulation is in accord with the statute. Even if this were less clear, the Regulation should be highly persuasive of the correctness of the decision below under the familiar principle, as expressed by the Supreme Court in *Commissioner v. South Texas Co.*, 333 U. S. 496, 501:

> This Court has many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons. See, *e. g., Fawcus Machine Co. v. United States*, 282 U. S. 375, 378.

Counsel make no attempt to reconcile their contention with the language of the Committee Report, the statute and the Regulations as indeed they cannot.

2. In a confused argument counsel contend (Br. 20-21) that the effect of our position here is that the Commissioner of Internal Revenue has taken upon himself to declare the state law at variance with controlling decisions of the State of California which are binding for federal tax purposes. The short answer is that the Commissioner has made no determination of state law either in accord with, or contrary to, decisions announced by the Supreme Court of California, because the law of California is not relevant to the present inquiry.

Taxpayer's position is contrary to the settled principle that federal revenue laws are to be construed in light

of the general purpose to establish a nationwide scheme of taxation uniform in its taxation. "Congress establishes its own criteria *and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law.*" (Italics supplied.) (*Lyeth v. Hoey,* 305 U. S. 188, 194. In accord: *Burnet v. Harmel,* 287 U. S. 103, 110; *Palmer v. Bender,* 287 U. S. 551, 555; *United States v. Pelzer,* 312 U. S. 399, 402; *Estate of Putnam v. Commissioner,* 324 U. S. 393.)

In *Lyeth v. Hoey, supra,* an heir had received a sum in settlement in litigation of a will. The taxability of that sum under the state statute depended upon the meaning of the statutory exemption, "acquired by inheritance." The law of the testator's domicile held that sums paid as will compromises were not inheritances. Acting on the principle that in the interest of uniformity exemptions under federal statutes should be determined by federal courts, the Supreme Court reached a contrary federal rule. The present situation is an *a fortiori* one because there is no provision of Section 162(d) the definition of which varies under the state law from what it would under the federal law. The statute unambiguously taxes to the recipient distributions which can or must be made out of other than income. The taxpayer's contention, then, is based on the patent fallacy that state law concepts developed in unrelated contexts are binding in the interpretation of the Internal Revenue Code even when Congress has plainly intended a uniform and contrary federal result.

II.

Section 162(d)(1) of the Code Is Constitutional.

1. Taxpayer contends (Br. 15-19) that Section 162(d)(1), as interpreted by the court below, conflicts with the Sixteenth Amendment, Appendix, *infra.* The contention is utterly without merit and there is real doubt whether taxpayer should even be heard here on that contention. The court below stated [R. 99] that "The constitutionality of that Section [Section 162(d)] is not challenged by the plaintiff." Although taxpayer's complaint [R. 3-13] purports to raise the constitutional issue, the court below apparently considered that the contention had been abandoned since it appears that it was not otherwise referred to before that court. In view of the unequivocal statement of the court below that the constitutionality of Section 162(d) had not been challenged, the failure of the taxpayer to move for rehearing or otherwise to object to that statement is at least indicative of the taxpayer's agreement that such was the fact. Accordingly, the firmly entrenched principle that an appellate court will not consider grounds for reversal not presented to the tribunal below, particularly as to constitutional questions, is fully applicable. (*Shahmoon v. Commissioner,* 185 F. 2d 384 (Cal. App. 2d); *Pacific Mut. Life Ins. Co. of California v. Barton,* 50 F. 2d 362, 367 (Cal. App. 5th), certiorari denied, 284 U. S. 647; *Wabash Ry. Co. v. City of St. Louis,* 64 F. 2d 921, 929 (Cal. App. 8th), certiorari denied, 290 U. S. 668, and cases there cited.

2. The Sixteenth Amendment to the Constitution grants the power to Congress to tax income without apportionment. Taxpayer's contention (Br. 15-19) that Section 162(d)(1) as interpreted by the court below is

unconstitutional proceeds on the untenable assumption that Congress is bound by the nomenclature of the parties in exercising its power under the Sixteenth Amendment to tax "income." Actually, this assumption by taxpayer's counsel violates perhaps the most firmly established and most fundamental principle that has evolved in the interpretation of the revenue laws. It was announced in the earliest decisions after the adoption of the Sixteenth Amendment as stated in *United States v. Phellis,* 257 U. S. 156, 168, that—

> We recognize the importance of regarding matters of substance and disregarding forms in applying the provisions of the Sixteenth Amendment and income tax laws enacted thereunder. In a number of cases besides those just cited we have under varying conditions followed the rule. *Lynch v. Turrish,* 247 U. S. 221; *Southern Pacific Co. v. Lowe,* 247 U. S. 330; *Gulf Oil Corporation v. Lewellyn,* 248 U. S. 71.

It has been constantly adhered to since. (*Commissioner v. Sunnen,* 333 U. S. 591; *Helvering v. Clifford,* 309 U. S. 331; *Helvering v. Stuart,* 317 U. S. 154; *Harrison v. Schaffner,* 312 U. S. 579; *Douglas v. Willcuts,* 296 U. S. 1; *Corliss v. Bowers,* 281 U. S. 376; *Burnet v. Wells,* 289 U. S. 670; *Commissioner v. Court Holding Co.,* 324 U. S. 331; *Griffiths v. Commissioner,* 308 U. S. 355; *Gregory v. Helvering,* 293 U. S. 465; *Weiss v. Stearn,* 265 U. S. 242.

Looking at the realities of this situation, it is evident that the general plan of the decedent was to replenish any reductions of the trust corpus by reason of the distributions with the trust income "immediately" as income was received [R. 96]; thus his plan accomplished in a roundabout fashion what could have been done directly,

namely, adding income to corpus and distributing "corpus" instead of distributing income directly to the extent of five per cent of the corpus. As decedent's plan worked out in practice, there was never any invasion of "corpus" or distribution of "corpus" in the true sense of that term. The trust income in the tax year being greater than the amount distributed, there was at the end of the year an amount in "corpus" greater than that which was in existence at the beginning of the year. No matter how artful the choice of language in the trust instrument, the circumstance cannot be denied that the trust ended the year with more corpus than it started with, that is income over expenses ($24,348.14) as such disappeared, and that the beneficiary received $18,356.36.

The congressional direction that to the extent that such increment is distributed to a beneficiary it shall be considered as his income is a simple recognition, as applied to this case, of the realities and a direction to disregard the subterfuges by which the testator through the use of language sought to convert what in the normal meaning of the term was "income" into principal. Indeed, the very provision that the taxpayer was entitled to an amount equal to five per cent of the corpus was probably the testator's estimate of what the trust would earn. The taxpayer's receipt of the distributions from the trust each year had the same economic value to her whether called "income" or "principal" by the testator. And it is the receipt of that economic value or satisfaction on which the tax is levied.

Although an estate or trust on the one hand and a beneficiary on the other are separate taxpayers, it is not to be disputed that a trust is an abstraction and that the economic pinch must actually be felt by flesh and blood

persons. While it is true, as taxpayer contends (Br. 19), that the law has dealt with the abstraction for income tax purposes as having a separate existence (*cf. Anderson v. Wilson*, 289 U. S. 21), it certainly does not follow that Congress may not constitutionally either ignore the abstraction or treat it as a conduit and impose the tax upon those beneficially interested in the income (*cf. Corliss v. Bowers*, 281 U. S. 376).

The excellent opinion of the court below quotes from the opinion of Justice Cardozo in *Burnet v. Wells, supra,* page 675, where it is stated that "One can read in the revisions of the revenue acts the record of the Government's endeavor to keep pace with the fertility of invention whereby taxpayers had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens." This case and this statute are a splendid illustration of Justice Cardozo's statement. The apt language of the court below, as follows, accurately and succinctly discloses the situation [R. 100]:

> To *acceed* [*sic*] to the plaintiff's contention would be to not only disregard the plain intent of Congress, but also to misconstrue the language of the Statute. A provision in a will cannot change the character of the actual earnings of a trust estate after death of the testator under the Internal Revenue laws by simply changing the name of the earnings from income to corpus either upon the receipt of the earnings or at the time of an annual appraisal. As I read the Statute it comes to this; if there actually was income, and if any money was distributable, and the money distributable and distributed, was less than the income, then it was "distributable income" within the meaning of the Statute, and is taxable to the recipient.

In light of what we have said, it is apparent that taxpayer's principal reliance (Br. 19) for the statute's unconstitutionality that "No sound reason exists why in the instant case it should be construed that the burden of the income tax should be shifted from one tax paying entity, to-wit: the trust, to another, to-wit: the beneficiary" is without merit.[4]

3. We have pointed out thus far: (1) That no constitutional issue is properly before the court and (2) that in any event the constitutional contention is not well founded because it is based on the unsupported assumption contrary to all the authority that Congress has no power to deal with the obvious device disclosed by this record which, by choice of language, would immunize the recipient of recurrent payments of trust income from income tax. The contention that the statute is unconstitutional fails for yet another reason.

Assuming that we are incorrect in arguing as we have that what the taxpayer actually received was not a portion of corpus transferred at death rather than income from that corpus, taxpayer's second underlying assump-

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[4]Actually taxpayer has no even superficially convincing argument for the statute's unconstitutionality. The argument is at best circular in that counsel merely assert that the statute is unconstitutional and use this assertion to base the contention that it should be construed otherwise than it was below, ignoring, as we pointed out in part I, *supra,* that the statute, its history and its administrative interpretation are so clear as to leave nothing that may properly be left to the field of "interpretation." Overlooked, completely, too, is the fundamental principle that a statute is presumed to be constitutional and all reasonable inferences must be drawn in favor of constitutionality. *United States v. Fox,* 95 U. S. 670; *Green v. Frazier,* 253 U. S. 233; *Madden v. Kentucky,* 309 U. S. 83. In sum, counsel's unconstitutionality contention is an unsupported assertion of unconstitutionality as a device to "interpret" the statute in a manner that is untenable.

tion that a gift of corpus may never be constitutionally treated as income to the recipient is reached. But that assumption is without support in any of the cases, and there is much by way of analogous authority which points to the opposite conclusion.

The question whether an outright gift may be constitutionally taxed to the donee has been a subject for theoretical discussion since the first days of the income tax statutes. Because gifts have been expressly exempted from income under Section 22(b)(3) of the Code and its counterparts in the various Revenue Acts, the question has never come before the courts. The inference which taxpayer draws from the exemption in Section 22(b)(3) (Br. 17-18) that Congress thought that it does not have the constitutional power to tax gifts is the opposite inference from that drawn by the courts and commentators. See, for example, the opinion of Judge L. Hand in *Rice v. Eisner,* 16 F. 2d 358, 360 (Cal. App. 2d), where it was stated that the provision of Section 22(b)(3) "shows that in the minds of those who drew the acts it was thought open to question whether even this might not be considered income." And see generally Magill's Taxable Income (Rev. ed.), chapter 11.[5]

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[5]Taxpayer's reliance (Br. 16-17) on *Irwin v. Gavit,* 268 U. S. 161, for the proposition that periodic sums acquired out of corpus are constitutionally exempt from tax is unsupported by that decision. The full opinion indicates that the Court was merely dealing with a hypothetical contention of taxpayer which assumed that gifts of corpus could not be taxed and the Court merely pointed out that it could distinguish the case before it of gifts of income from corpus (p. 168) "*assuming* that the gift supposed would not be income." (Italics supplied.)

But in any event, there is no question before this court as to whether outright periodic gifts of corpus could be constitutionally taxable as income since the tax here is levied on income which arose from the corpus after the date of decedent's death. Rather we have here the much narrower question, even on the assumption most favorable to taxpayer (that she received a gift of corpus), of whether Congress has the power to state, as between a trust and its beneficiaries, which shall be liable for the tax on income earned by the trust.

In situations that closely parallel the instant one, the Supreme Court has had no hesitancy in taxing to donees, or even to purchasers for value, the realized increment on the disposition of an asset that came into existence before the donees' or purchasers' acquisition of the asset. Thus in *Taft v. Bowers,* 278 U. S. 470, and in *Cooper v United States,* 280 U. S. 490, the provision of the Revenue Acts was upheld that a donee is required to pay an income tax on the difference between the selling price of property received by gift and the value when the donor acquired the property notwithstanding that the entire appreciation in value may have taken place prior to the gift. The court expressly acknowledged that in one sense the donee was being taxed on a portion of a gift of property, but justified the result on various grounds including that it was necessary to prevent the escape of tax and that the donee was not being treated arbitrarily or unfairly. Similarly here, Congress must be deemed to have constitutional authority to prevent the compartmentalizing of in-

come to avoid surtax to those who have the beneficial interest in the trust income. And certainly there is nothing arbitrary or capricious about a result that would tax the distribution here involved as income to this taxpayer who actually received amounts less than the trust received as income.

Similarly, the Supreme Court has had no difficulty in justifying the constitutionality of provisions of the Revenue Acts which tax to purchasers of stock the full dividend paid on such stock notwithstanding that the price paid included a portion or even the full amount of the dividend. (*United States v. Phellis,* 257 U. S. 156.)

Finally, Section 162(d) in requiring all distributions to be taxed to the recipient, to the extent that the trust has income, precisely parallels the much older provision in Section 115(b) of the Code which creates an irrebuttable presumption that distributions by corporations are made out of earnings and profits "and from the most recently accumulated earnings and profts." Under that provision, a label by a corporation that a distribution is out of corpus would be of no avail. That there appear to be no cases where a taxpayer has even contended that the provision is unconstitutional strongly suggests that there is no merit in such a position and because of the closeness of the analogy between that section and Section 162(d) attests the unreasonableness of taxpayer's position here.

Conclusion.

The decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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March, 1951.

APPENDIX.

United States Constitution, Amendment XVI.

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code:

Supplement E—Estates and Trusts.

* * * * * * * *

Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * * * * *

(b) [Amended by Sec. 111(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. * * *

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(d) [added by Sec. 111(c) of the Revenue Act of 1942, *supra*] *Rules for Application of Subsections (b) and (c)*.—For the purposes of subsections (b) and (c)—

(1) *Amounts Distributable Out of Income or Corpus*.—In cases where the amount paid, credited, or to be distributed can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid, credited, or to be distributed to any legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of such distributable income as the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to legatees, heirs, and beneficiaries for the taxable year of the estate or trust. For the purposes of this paragraph "distributable income" means either (A) the net income of the estate or trust computed with the deductions

allowed under subsections (b) and (c) in cases to which this paragraph does not apply, or (B) the income of the estate or trust minus the deductions provided in subsections (b) and (c) in cases to which this paragraph does not apply, whichever is the greater. * * *

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(26 U. S. C. 1946 ed., Sec. 162.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.162-2. ALLOCATION OF ESTATE AND TRUST INCOME TO LEGATEES AND BENEFICIARIES.—(a) *Allocation among annuitants.*—Section 162(d)(1) applies to all cases in which the executor or trustee can or must (for example, by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest, devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir or beneficiary of a lump sum gift, bequest, devise, or inheritance. It applies in all cases of annuities where any deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies in cases where amounts are to be paid or credited at intervals and the executor or trustee has discretion whether to pay or credit such amounts out of income or corpus, regardless of the source (income or corpus) to which the executor or trustee attributes such amount. If an annuity is paid, credited, or to be distributed tax-free, that is, under a provision whereby the executor or trustee will pay the income tax of the annuitant resulting from the receipt of the annuity, the payment of or for the tax by the executor or trustee will

be income to the annuitant under the rules of section 162(d) to the extent such payment is treated thereunder as out of income.

The method of allocating income of the estate or trust for its taxable year in cases to which section 162(d)(1) applies is as follows: The aggregate of all amounts which can be paid, credited, or distributed out of other than income (except under a gift, bequest, devise, or inheritance not to be paid, credited, or to be distributed at intervals) is obtained. The aggregate of such amounts is considered to be paid, credited, or distributed in such cases out of income of the estate or trust for its taxable year if it does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts does exceed the distributable income of the estate or trust for its taxable year, the portion of such amount paid, credited, or to be distributed to a legatee or beneficiary is considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of all distributable income as the amount so paid, credited, or to be distributed to the legatee or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to such legatees or beneficiaries for the taxable year of the estate or trust. The proportion stated in the preceding sentence applies only to legatees or beneficiaries of amounts which can be paid, credited, or distributed out of other than income of the estate or trust and, in computing such proportion, the amount of any gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals is not to be included.